



NATIONAL STOCK EXCHANGE OF INDIA LIMITED



ANMI Members meet on Compliance and Inspection

July 22, 2011

Compliance requirements



- Compliance means ensuring conformity and adherence to regulatory acts, rules, procedures, laws, regulations, directives and circulars.
- Compliance requirement broadly flow from the relevant provisions of SCRA 1956; SCRR 1957, SEBI Act, Rules, Regulation and Circulars ,Rules, Regulations, Bye-laws & Circulars of NSEIL & NSCCL



Compliance V/s Business Dilemma

High Costs

Clarity

Software Issues

Manpower

Client Resistance

Deadlines

Business Development

Regulatory Actions



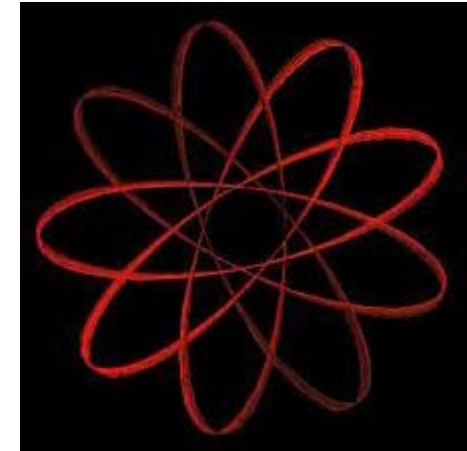
Benefits of Compliance



- Business Continuity
- Compliance & Risk Management (less risk, less bad debts)
- Compliance & Growth (introduction of new products)
- Compliance & Credibility (client confidence)
- Reputation & Goodwill (in the market place & with regulators)
- Healthy Financials- better liquidity
- Robust Internal controls
- Compliance & Peace of mind



Compliance and Regulatory Requirements



- Requirements to be adequate neither Excessive nor Inadequate
- Exchange monitors level of compliance by analyzing data/ Information/ submissions available with the Exchange
- Data/ Information/records available at members offices verified during the Inspection
- Inspection a regulatory requirements & a tool to monitor level of compliance
- Inspections to be risk based, swift & value adding
- Internal Audit report requirements



Commonly found Observations

Observations are broadly categorized into the following areas



Client Registration



- Non Execution of documents KYC /MCA / RDD, Incomplete Documents/no separate docket
- Contradictory clauses in voluntary or mandatory documents/ Jurisdiction
- In-person verification not done
- Non Collection of documents/details like address/identity/PAN/ Bank/ DP
- Non delivery of set of documents executed to clients
- Non compliance of requirements as per December 03, 2009 circular of SEBI
- Index page not maintained
- Clients countersign against the segment/exchange in KYC not obtained
- Identity & address of the introducer not captured in KYC
- Details of action taken against a client not obtained
- Financial information & supporting documentary evidence not obtained
- Up-dation of financial information and periodic reviews not done



Provisions of PMLA



Account opening procedure- Anti Money Laundering Requirements

Client Due Diligence

Client Identification procedure

Policy for acceptance of clients & risk based approach

Classification of Clients of special category (CSC)

Provisions of PMLA (Cont...)



- Verify the client identity using reliable, independent sources, documents, data or information.
- Verify the identity of beneficial owner of the client and/or the person on whose behalf transactions are to be conducted and obtain sufficient details
- Ensure that no account is opened in a fictitious / benami name or where the intermediary is unable to apply appropriate CDD measures/KYC policies
- Classify the clients into low, medium and high risk category based on risk perception
- Clients of special category like NRI,HNI,Trust,NGO,PEP, Non face to face etc.to be classified as high risk clients and closely monitored
- Client transactions not to be disproportionate to their financial strength
- Identify suspicious transactions and file STR wherever required
- The identity records of clients to be preserved for a period of 10 years from the date of cessation of the transactions between the client and intermediary

Dealings with Clients (Cont...)



RUNNING ACCOUNT AUTHORIZATION

- Running account authorization is voluntary at client's discretion
- Authorization shall be dated and contain a clause, stating that client can revoke authorization at any time.
- Authorization shall be signed by the client only & not by any POA holder.
- If a member has obtained such authorization from the client, the member needs to intimate clients in the periodical statement of accounts that "the authorization shall continue till the same is revoked by the client"



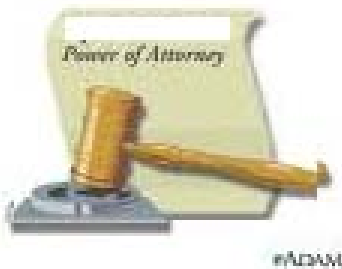
Dealings with Clients



SETTLEMENT OF FUNDS & SECURITIES

- In case of running account compulsory settlement to be done on monthly/quarterly basis as per client preference, across the segments
- Retention of funds and securities at the time of settlement may be as under
 - *Derivative market - trading member may retain up to 175% of margin requirement*
 - *Capital market – trading member may retain entire outstanding pay-in obligation of funds & securities and value of transactions executed on the day of settlement.*
- No inter-client adjustment for the purpose of settlement
- Issue statement of funds & securities along with retention details
- Pass corporate benefits like rights, bonus, dividend etc to respective clients

Dealings with Clients (Cont...)

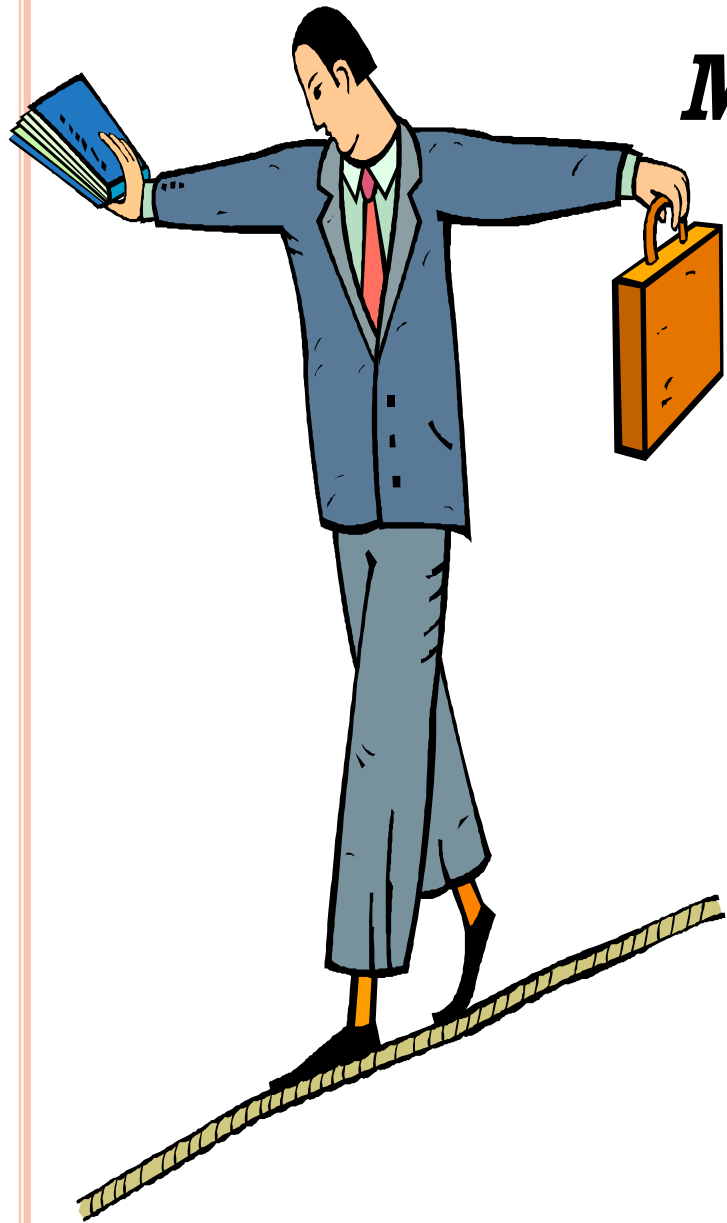


COMPLIANCES RELATED TO POA

- A POA is voluntary and at client's sole discretion
- Shall not give any exclusive right or control over the DP account or ledger account or bank account of client
- POA should be used for the purposes permitted by SEBI
- POA should not permit
 - Transfer of securities for off market trades
 - Opening a trading or DP account in the name of client
 - Execute trades in the name of the client without its consent
 - Prohibit issue of Delivery Instruction Slips to client.
 - Prohibit client(s) from operating the account
 - Allow merging of balances (dues) under various accounts



Margin Reporting



Margin Reporting (Cont...)

COLLECTION OF MARGINS



"You can't live like there's no tomorrow, and then live tomorrow."

- Margins are an important element of the risk management system
- Members should have a prudent system of risk management to protect themselves from client default.
- The same shall be well documented and be made accessible to the clients and the Stock Exchanges.
- In the cash segment the quantum of these margins and the form and mode of collection are left to the discretion of the members



Margin Reporting (Cont...)

COLLECTION OF MARGINS – DERIVATIVES SEGMENT



- In the Derivatives segment members are required to collect and report details of upfront margins collected from all their Clients
- Trading member can report client margin details to clearing corporation up-to T+2 day
- Non reporting is considered as 100 % shortfall
- Margins should be available with the member and should be in approved forms only (Liquid securities / free funds)
- Penalty would be imposed in case of shortfall or wrong reporting
- In case of non receipt of pay-in of funds/ securities beyond a reasonable time gap, not desirable to allow further positions
- Exposure allowed to clients should be in proportion to margins and financial strength

Trading Terminals



- To be located only in the office of the Trading Member / sub-broker / authorised persons offices
- No extension of NEAT terminal without prior approval of the Exchange.
- To be operated by approved persons only.
- Upload trading terminal details to the Exchange before activation.
- All information to be correctly uploaded in the prescribed format particularly user name, location and terminal id.
- Any change in the details to be immediately updated in Exchange records.
- PRO trading to be done only from trading terminals enabled for PRO trading
- Trading terminals in the CM/ F&O/Currency segment to be operated by users having valid certifications only.



Other Observations / Bad practices



- Mis-utilization of client funds / securities for the use of self/other clients
- Execution of trades of multiple clients in the same code and transfer of same in the back office to different clients accounts
- Modification of client trades and transfer profitable trades to related entities
- Funding to clients by self/ through NBFC
- Considering cheques not deposited / held in hand for substantial periods while reporting margins to the exchange
- Unexplained use of funds raised by pledge of client securities
- Unauthorized trades in clients accounts
- Surveillance/ Risk /Back office functions not segregated leading to fraud
- Acceptance of Cash/ DD/ pay order and credit to other client accounts
- Offering fix returns / creation of e-mail IDs of clients



New Regulatory Requirements

PRE FUNDED INSTRUMENTS



- In case of payment received through pre-funded instruments, like, Pay Order, Demand Draft, Banker's cheque etc. members need to ensure that the funds are not received from third parties.
- If the value of pre-funded instruments is Rs. 50,000/- or more, per day per client, the stock brokers may accept the instruments only if the same are accompanied by proofs like
 - ✓ ***Certificate from the issuing bank on its letterhead or on a plain paper with the seal of the issuing bank.***
 - ✓ ***Certified copy of the requisition slip (portion which is retained by the bank) to issue the instrument.***
 - ✓ ***Certified copy of the passbook/bank statement for the account debited to issue the instrument.***
 - ✓ ***Authentication of the bank account-number debited and name of the account holder by the issuing bank on the reverse of the instrument.***
- Members should also maintain an audit trail of the funds received through electronic fund transfers to ensure that the funds are received from their clients only.

New Regulatory Requirements (Cont...)

RESPONSIBILITY OF COMPLIANCE OFFICERS



- Keep check on Type of Investor complaints received
- To report Arrest / conviction of key officials
- Report activities carried out, if any, in any business other than that of securities.
- To report if Membership to the stock Broker or Group Company is refused by any Regulator
- To Report regulatory action on Stock Broker or Group Company
- Technology failure at Stock broker entity impacting servicing of more than 25% of its customers.
- Financial disputes before various Government organization / bodies created under Act of Parliament involving a value of more than 25%, on cumulative basis, of the Net-worth of the Stock Broking entity
- Any other important event



New Regulatory Requirements (Cont...)

ONLINE CLIENT CODE MODIFICATION

- Client Code Modification for Non institutional clients to be fined at SEBI prescribed rates
- Fine levied to be 1% or 2% of the value of trades modified during a month as may be applicable
- Avoid back office transfer of trades



NISM CERTIFICATION FOR PERSONS DEALING WITH CLIENTS

- All persons associated with stock brokers need to get Certified if they are involved with or deal with any of the following
 - “Assets / funds of clients or Redressal of Invertor grievance or activities having bearing on operational risk”***
- All employees of trading member should be certified as under
 - ***New employees within 1 year from date of circular***
 - ***Existing employees should obtain certification within 2 years***



NEW REGULATORY REQUIREMENTS

(CONT...)

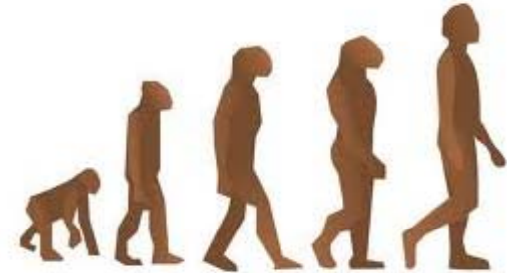
MARKET RUMORS



- Stock broker should have proper systems to ensure that
 - ***Employees / temporary staff / voluntary workers etc. do not encourage or circulate rumors or unverified information***
 - ***Access to Blogs/Chat forums/Messenger sites etc. should either be restricted under supervision or access should not be allowed***
 - ***Logs for any usage of such Blogs/Chat forums/Messenger sites (called by any nomenclature) should be maintained by members***
 - ***Employees should be directed that any market related news received by them either in their official mail/personal mail/blog or in any other manner should be forwarded only after the same has been seen and approved by the Compliance Officer***



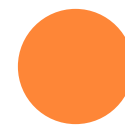
Regulatory Initiatives

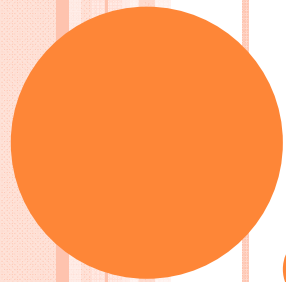


- Issue of FAQ on Dealings by NRIs
- Review of details included in compliance calendar / hand book / consolidated circular with reference to recent circulars
- Members education on compliance requirements
- Conducting compliance visits for creating awareness among new members
- Initiated review of client registration documents to make the same cost effective and user friendly
- Clarifications regarding Power of Attorneys obtained from clients of trading members
- Clarifications regarding pre funded instruments
- Clarification regarding undertaking for running account maintenance



THANK YOU





QUESTIONS ???